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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 000274

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FOR MILLENNIUM CHALLENGE BOARD FROM CHIEF OF MISSION  
STATE FOR S, F, D, P, E, EUR/FO, EUR/CARC, EUR/ACE, EEB, DRL  
USAID FOR ADMINISTRATOR  
WHITE HOUSE FOR USTR  
MCC FOR CEO DANILOVICH  
NSC FOR MARIA GERMANO  
TREASURY FOR SECRETARY AND MCC-RELATED POLICY STAFF

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SUBJECT: TOUGH LOVE: ARMENIA'S MILLENNIUM CHALLENGE PROGRAM

Classified By: CDA Joseph Pennington, reasons 1.4 (b,d)

¶1. (C) As we consider the future direction of U.S. relations with Armenia in light of recent problems and broader negative trends in Armenia's democracy and human rights record, the future of Armenia's continued eligibility for the Millennium Challenge Account (MCA) should be high on the agenda. Our strong view from Embassy Yerevan is that absent significant, tangible reform in the coming months, a failure to suspend the MCA program in Armenia will destroy the credibility of MCA as a meaningful incentive for democratization and reform in Armenia. After months of shrugging off the MCA indicator eligibility criteria, senior Armenian leaders now seem to believe for the first time that the MCA program could indeed be terminated. We see evidence of this in recent public statements by President Kocharian and other senior leaders implying that Armenia does not really need MCA funding -- an apparent attempt to prepare Armenian public opinion for MCA termination. In view of the authorities, disastrous handling of the presidential election and its aftermath, a failure to impose any tangible penalty in the MCA program would be read here -- by the government, the opposition, civil society, and the Armenian public -- as proof that Armenian authorities can get away with anything, and that the MCC eligibility criteria have no teeth.

¶2. (C) OUR RECOMMENDATION: Armenia's MCC eligibility has been in jeopardy for some time, due largely to the GOAM's continued failure to carry out significant democratic reform and to tackle corruption. Armenia is currently failing on five of the six indicators in the Ruling Justly category. Following the MCC Board meeting in December, the GOAM was reminded of the problems with its performance on MCC indicators and asked to develop a credible plan for remediation. Since that time, however, the authorities, handling of events surrounding the February 19 presidential election have caused conditions in the country to deteriorate dramatically. The government's serious violations of political and human rights spanned the pre-election campaign period, Election Day itself, and the post-election period. We believe the time is now to use the incentive value of the MCA program to promote the President's freedom agenda in Armenia. If handled well, the MCA program may be able to catalyze bolder democratic reforms than the Armenian

government would otherwise undertake, and help get Armenia back on track. We propose a multi-step approach that would protect MCA credibility and maximize its incentive value, while optimizing the chance that the Armenian program can be completed successfully.

Specifically, we recommend the following:

-- First, MCC should immediately signal its intention to hold up signing of any/all large-scale new contracts until after the June meeting of MCC Board. This would underline the seriousness with which the MCC Board views the eligibility criteria and Armenia's poor performance. At the same time, it would do no lasting harm to MCA implementation if the authorities turn the situation around.

-- Second, the June MCC Board meeting seems an appropriate time to review Armenia's eligibility. President-elect Serzh Sargsian will be inaugurated on April 9. By June he will have had sufficient opportunity to demonstrate a fast-breaking commitment to address Armenia's failings in the post-election period. We recommend that the Embassy be authorized to foreshadow explicitly to Armenian authorities and other relevant players that the time between now and the June Board meeting is a window of opportunity. If the new administration shows dramatic positive steps, then it may be able to avoid penalty in June. However, absent such steps, Armenia should anticipate a formal suspension notification following the June Board session. President-elect Sargsian and his supporters have hinted strongly that Sargsian has been unable to sway outgoing President Kocharian from his determination to impose authoritarian solutions to the problems posed by the election aftermath. This tactic will give the new president the opportunity and obligation to put his money where his mouth is.

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-- Third, suspension should be imposed in June, presuming (as we think most likely) that the new president makes only modest positive steps between now and then. At the same time, we should point out to the Armenian government that a brief suspension would not do irreparable harm to implementation of the Compact. We should make clear that that the September session of the MCC Board will be an opportunity for Armenia's Compact to be reinstated if the new administration is able to take the bold steps necessary to clean up its record on protecting human and political rights.

If reinstated in September, the Compact will have suffered little if any lasting damage. Such a reinstatement, if merited, could be chalked up by the new President as an achievement that signals a distinctive break with the past and a reversal of Armenia's authoritarian trend. Such an outcome would strengthen the Sargsian administration, Armenian democracy, and the U.S.-Armenian bilateral relationship. Sargsian would then be in a better position both to establish his legitimacy and to become a strong partner on other major U.S. policy priorities including a peaceful settlement in Nagorno Karabakh, rapprochement with Turkey, and Armenia's further Euro-Atlantic integration.

13. (C) The argument has been made that by some that being tough on President-elect Sargsian will only drive him into deeper dependence on the worst influences on the Armenian scene, both foreign and domestic. We disagree. If, as Sargsian and his allies so badly want us to believe, Sargsian is at heart a reformer who needs only to be elevated to full power to show his merit, this strategy will give him ample chance to demonstrate that. Indeed, clear and unambiguous pressure from the United States can be a strong weapon in Sargsian's arsenal for attacking entrenched, corrupt interests in the ruling party establishment. If, however, the PM seeks to return Armenia to the soft authoritarianism of the pre-election period, where democratic progress is measured in millimeters, we should not allow ourselves to be complicit in that process. Sargsian's failure to show

leadership in preventing the ruling party from rigging the election in his favor and then brutally cracking down on the opposition means that we do not owe him the benefit of the doubt. We should demand a full, upfront downpayment of democratic achievement before extending him further credit.  
PENNINGTON